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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	)	CC Docket No. 00-256
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Access Charge Reform of Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation	)	CC Docket No. 98-77
	)	
Prescribing the Authorized Rate of Return For Interstate Services of Local Exchange Carriers	)	CC Docket No. 98-166

REPLY COMMENTS OF THE LEC MULTI-ASSOCIATION GROUP

FILING ASSOCIATIONS:

National Rural Telecom Association

National Telephone Cooperative Association

Organization for the Promotion and Advancement of Small Telecommunications Companies

United States Telecom Association

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March 12, 2000

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SUMMARY

The LEC Multi-Association Group (the "Group"), consisting of NRTA, NTCA, OPASTCO, and USTA, respectfully replies to initial comments on the comprehensive plan (the "Plan") that the Group filed on October 20, 2000. The comments on the Plan demonstrate that it strikes a reasonable balance in addressing the many issues surrounding the regulation of non-price cap LECs and IXCs. A wide variety of commenters supports the Plan's efforts to reform the access charge system and to introduce portable explicit universal service support mechanisms for non-price cap LECs. The Commission should adopt the Plan as submitted by the Group.

The Plan seeks to provide regulatory certainty for non-price cap LECs and their customers. The Commission should evaluate the Plan as a whole at this time and in this proceeding. The Commission should reject AT&T's proposal to address only access issues for implementation on July 1, 2001, and defer consideration of incentive regulation to "the next phase" of this proceeding. Such an approach, which would split up the issues and start a new proceeding on incentive regulation, would merely extend and intensify the uncertainties and risks that the regulatory process of recent years has imposed on non-price cap LECs. Nor should the Commission reopen its rate of return represcription proceeding, CC Docket No. 98-166.

The Commission should reject attempts of commenters to eliminate a basic element of the Plan: the two alternate regulatory paths -- "Path A" and "Path B" -- that would be available to non-price cap LECs. These paths, designed to accommodate the great diversity of non-price cap LECs, are essential to a realistic plan for improved regulation of non-price cap LECs. The Commission should reject AT&T's suggestion to replace the Path A/Path B approach of the Plan with an alternative two-tier approach. Not only is AT&T's approach untenable on its own terms,

but the mandatory nature of its proposal completely ignores the diversity among non-price cap LECs that the record establishes so clearly.

Commenters from many telecommunications sectors support the Plan's proposal to increase SLCs to the levels of the caps established in the *CALLS Order*. The Commission should adopt the Plan's proposals for the timing and magnitude of such SLC increases, which were designed to balance customer concerns about rate shock with the need to improve recovery of common line costs. Nor should the Commission change the Composite Access Rate ("CAR") from the Plan's approach of transitioning to a level of 1.6 cents per minute as of July 1, 2003.

The Commission should also reject attacks on the Plan's proposal to enforce the geographic averaging requirement of section 254(g) of the Act. With the more economically efficient access charges that will result from the Plan, IXCs will more readily be able to satisfy the section 254(g) requirement.

The Commission should adopt the many reforms of the universal service system proposed in the Plan. As the Wisconsin PSC states, the Commission should immediately remove the "interim" cap on high cost loop support. The Commission should also remove the corporate operations expense limitation.

The Commission should not alter Rate Averaging Support (the "RAS"), the explicit and portable universal service support mechanism defined in the Plan. The availability of the RAS to pooling LECs in Path A will motivate non-price cap LECs to elect Path A. As a residual mechanism for supporting access charge reductions, the RAS should not be subject to caps or fixed at a specific size. The part of the RAS that supports special access services is essential to avoid rate shock and to permit investment in the modern technologies needed in rural areas. The need for LECs to have the ability to disaggregate universal service support is well established.

Some commenters express concern about the overall size of universal service funding, noting that IXCs and LECs already contribute about 6.7% of their interstate and international end user revenues to such funding. However, the rural areas served by non-price cap LECs continue to be the focus of universal service policies in the United States. Whatever competing uses exist for universal service funding, these areas and the LECs that serve them should receive sufficient support under the Act.

The Commission should adopt Path A and its form of incentive regulation proposed in the Plan. Path A provides the correct signals and incentives for efficient investment and operations by non-price cap LECs operating in a pooling environment. Path A's transition mechanism for moving from existing forms of rate-of-return regulation to Revenue Per Line ("RPL") incentive regulation should be adopted. Non-price cap LECs should be able to convert to Path A incentive regulation during the transition period on a per-study area basis.

The Commission should reject calls to add a "productivity factor" or similar X-factor onto Path A incentive regulation. Rural LECs do not have the size or operating scale to accommodate an annual productivity offset. The Commission did not impose mandatory price cap regulation on small and mid-sized LECs because it was unreasonable to subject them to a form of incentive regulation based on the historical performance of the largest LECs, including the productivity estimates that comprise the price cap X-factor.

AT&T presents a backward-looking analysis in its comments that purports to show that Path A incentive regulation should include a productivity factor to reflect LEC productivity gains in switching and transport. However, the period chosen for analysis, 1995-1999, was one of very strong economic growth. The analysis includes several assumptions that cast doubt on the validity of its productivity estimate. Nor should the Commission alter the low end adjustment proposed in the Plan.

NECA's centralized tariff and pooling system eases administrative and regulatory burdens. Pooling is compatible both with incentive regulation and with implementation of the Plan as a whole.

The Plan provides strong incentives for non-price cap LECs to invest in new infrastructure. But the Plan avoids mandatory use of universal service funding to support advanced services. Nor is the Plan designed to change the definition of services eligible for universal service funding to include advanced services.

The Commission should repeal several of its rules that discourage non-price cap LECs from acquiring and upgrading the exchanges and facilities of other LECs. The record demonstrates that these rules impose few benefits and many burdens on non-price cap LECs.

The Group urges the Commission to adopt the Plan as filed, as expeditiously as possible.

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REPLY COMMENTS OF THE LEC MULTI-ASSOCIATION GROUP

I. INTRODUCTION

The LEC Multi-Association Group (the "Group")[1] respectfully submits reply comments in the above-captioned proceeding regarding the comprehensive plan (the "Plan") that the Group filed on October 20, 2000 in a petition for rulemaking (the "Petition").[2]

[1] The Group consists of the National Rural Telecom Association ("NRTA"), the National Telephone Cooperative Association ("NTCA"), the Organization for the Promotion and Advancement of Small Telecommunications Companies ("OPASTCO"), and the United States Telecom Association ("USTA").

[2] *See Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*. Notice of Proposed Rule, 66 Fed. Reg. 7725 (Jan. 25, 2001).

The comments on the Plan demonstrate that it strikes a reasonable balance in addressing the many issues surrounding the regulation of incumbent local exchange carriers not subject to price cap regulation ("non-price cap LECs") and interexchange carriers ("IXCs"). The Commission should adopt the Plan as submitted by the Group.

A broad spectrum of commenters supports the Plan's efforts to reform the access charge system and to introduce portable explicit universal service support mechanisms for non-price cap LECs.[3] Numerous non-price cap LECs and their representative associations note the importance of the Plan's design for regulatory options and the need to adopt the Plan in its entirety.[4]

A major objective of the Plan is to provide regulatory certainty for non-price cap LECs and their customers. Indeed, at the request of former Chairman Kennard, the Group developed the Plan as an integrated solution to multiple pending regulatory proceedings. The Commission should evaluate the Plan as a whole at this time and in this proceeding. The Commission should reject AT&T's proposal to address only access issues for implementation on July 1, 2001, and defer consideration of incentive regulation to "the next phase" of this proceeding.[5] Such an approach - in essence, splitting up the issues and starting a new proceeding on incentive

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3 *See, e.g.*, comments of AT&T at 2; BellSouth Corporation and BellSouth Telecommunications Inc. ("BellSouth") at 2; Competitive Universal Service Coalition ("CUSC") at 2; General Communications, Inc. ("GCI") at 2; Global Crossing North America, Inc. ("Global Crossing") at 3; Plains Rural Independent Companies at 3-5; TDS Telecommunications Corporation ("TDS Telecom") at 1. All citations herein to the comments of a party refer to comments filed on or about February 26, 2001, in the above-captioned docket.

4 *See, e.g.*, comments of Alabama Rural LECs at 2-3; Alaska Rural Coalition; Alaska Telephone Association at 2; Arizona Local Exchange Carriers Association at 2; Innovative Telephone at 4-6; Interstate Telecom Group ("ITG") at 3; Roseville Telephone Company ("Roseville") at 2; TCA, Inc. at 2-4; Townes Telecommunications, Inc. ("Townes") at 1-4.

5 *See* comments of AT&T at 3. As discussed below, AT&T's proposals regarding incentive regulation are themselves unreasonable.

regulation - would merely extend and intensify the uncertainties and risks that the regulatory process of recent years has imposed on non-price cap LECs.

Similarly, the Commission should not reopen its rate of return represcription proceeding, CC Docket No. 98-166, as a few commenters argue.[6] To do so would also increase the regulatory uncertainties and risks faced by non-price cap LECs. As the Group and the Interstate Telecom Group ("ITG") show, retention of the current authorized rate of return is justified. ITG explains that the costs of capital and equity for rural LECs have increased due to the growth of regulatory uncertainty, competitive and other forms of business uncertainty, and technological uncertainty since 1990, when the current rate of return was authorized.[7] Qwest agrees that the rate-of-return docket should be closed, leaving the authorized rate of return at its present level.[8]

In the represcription proceeding, the associations in the Group urged the Commission to increase the prescribed rate of return if it chose to act in that proceeding. The associations demonstrated that the current authorized interstate rate of return of 11.25% is a conservative estimate of all LECs' current and prospective capital costs.[9] By continuing the current 11.25 percent authorized rate of return, the Commission can reduce the uncertainty about the prospective returns the non-price cap LECs are likely to achieve on investments in new telecommunications technologies and services. The non-price cap LECs will be more likely to

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6 *See, e.g.*, comments of General Services Administration ("GSA") at 15-16; CUSC at 14.

7 *See* comments of Interstate Telecom Group ("ITG") at 17-18.

8 *See* comments of Qwest at 2; see also comments of John Staurulakis, Inc. ("JSI") at 8-9.

9 *See* Joint Direct Case and Comments of Local Exchange Carrier Associations, CC Docket No. 98-166 (filed Jan. 19, 1999).

invest in new telecommunications technologies and services if they have reasonable assurances that they will be able to earn an adequate return on their investments over the life of the facilities.

Although some parties seek to condemn specific parts of the Plan because of alleged deficiencies, parties have conflicting views as to what those deficiencies are. Thus, for example, some parties believe that the subscriber line charges ("SLCs") proposed in the Plan are too high, while others believe that the proposed SLCs are not high enough.[10] Similarly, some parties attack the Plan's proposed transition to "Path A" incentive regulation as providing unwarranted incentives for investment, while others state that Path A incentive regulation provides insufficient investment incentives.[11] Some parties attack Path A incentive regulation as being too beneficial to those non-price cap LECs that would be subject to it, but many non-price cap LECs stress their desire to remain subject to traditional rate-of-return regulation under Path B.[12] These contradictory criticisms of major aspects of the Plan indicate that the Plan as proposed by the Group has struck an equitable balance.

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[10] *Compare, e.g.*, comments of Nat'l Assoc. of State Util. Cons. Adv. ("NASUCA") at 5 (opposing SLC increases) and ICORE companies at 15 *with* comments of Sprint Corporation ("Sprint") at 6 (stating that "the CALLS Plan SLC caps should be, if anything, be the minimum allowable SLC caps for this group of carriers").

[11] *Compare, e.g.*, comments of the Florida Public Service Commission ("Florida PSC") at 6-7 and comments of the People of the State of California and the California Public Utilities Commission ("California PUC") at 23 (expressing concern that the Plan will encourage excessive investment or "gold plating" of networks) *with* comments of AT&T at 12-13 (arguing that the Plan does not require investment in the network).

[12] *Compare, e.g.*, comments of CSUS at 8 (opposing size of proposed Rate Averaging Support ("RAS") fund in Path A of the proposed Plan) *with* comments of Plains Rural Independent Companies at 7-12; ITG at 8 (discussing reasons for small LECs not to elect Path A of the Plan).

In these reply comments, the Group discusses the major substantive objections to the Plan raised in the initial comments.[13] Many of these objections reflect individual commenters' interests in the multiple policy concerns that face non-price cap LECs. In this regard, some commenters seek to cast doubt on the Plan because it "was formulated solely by rate-of-return ILECs, whereas the CALLS Plan was developed through give-and-take negotiations between major price cap LECs and major IXCs."[14] Such commenters conveniently ignore the controversy and procedural disputes regarding the private negotiations that led to the CALLS Plan.[15] The Group believes, as stated in its initial comments, that this rulemaking proceeding is an excellent forum for addressing concerns about the Plan raised by other parties.[16]

Moreover, the factual situation facing the Commission with respect to the non-price cap LECs is far different from that of CALLS. The Commission should reject any argument that the CALLS regulatory regime can or should reasonably be imposed on the non-price cap LECs simply because it applies to the price cap LECs. The Commission historically has distinguished the numerous non-price cap LECs from the few large LECs for which price cap regulation is

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13 Because the Group believes that the record fully justifies adoption of the Plan as filed, it does not respond in detail to every criticism of the Plan, but focuses on those that were of greatest interest in the initial round of comments.

14 *See* comments of Sprint at 3. The CALLS Plan refers to the plan of the Coalition for Affordable Local and Long Distance Service ("CALLS") adopted in *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users, Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262 *et al.*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, FCC 00-193, 15 FCC Rcd 12962 (2000) (the "*CALLS Order*").

15 *See, e.g.*, Statement of Commissioner Furchtgott-Roth, concurring in part and dissenting in part to the *CALLS Order*.

16 *See* comments of the Group at 2 n. 3.

mandatory. The few major carriers involved in the CALLS negotiations served well over 80% of the access lines in the United States. The *CALLS Order* itself applies to the price cap LECs, which serve almost 93% of U.S. access lines. Those carriers and the large IXCs are firms with substantial, diversified resources, especially compared to the vast majority of non-price cap LECs. The more than 1000 non-price cap LECs that will be subject to the Plan serve between 7 and 8% of U.S. access lines and, as the Commission stated in 1998, account for about 9% of total access revenues.[17] These LECs are predominantly small businesses that serve diverse areas and customer bases with limited human and material resources. The relatively small size of the non-price cap LECs in the aggregate means that with the *CALLS Order*, the Commission has accomplished the "lion's share of nationwide access reform:"[18]

> As a result, the Commission is now in a position to deal flexibly and carefully with access mechanisms and revenues that are extremely important to small rural LECs, without adversely impacting the interexchange industry due to the very small portion of nationwide access charges at issue.[19]

Regulatory changes that might be practicable for large carriers could impose major unforeseen harms on many of these carriers.[20] This is due not only to differences in scale and scope between these LECs, but also to the fact that the majority of LECs subject to the Plan are currently in a pooling environment, which is fundamentally different than the individualized tariffing and collection environment of the CALLS participants.

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17 *See Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, Notice of Proposed Rulemaking, 13 FCC Rcd 14238, 14244 (1998).

18 *See* comments of ITG at 7.

19 *Id.*

20 Thus, as discussed further below, the Commission should reject AT&T's attempt to [illegible]andedly impose incentive regulation and access charge changes substantially more [illegible] than those in CALLS on non-price cap LECs.

Some commenters also raise issues regarding the jurisdiction of the Federal-State Joint Board and coordination of this proceeding with the proceeding on the RTF recommendation.[21] The Group agrees with TDS Telecom that the Commission should coordinate and sequence this proceeding and that on the RTF recommendation so that it can "responsibly exercise its sole jurisdiction with respect to the interstate access issues and reach a truly comprehensive reform determination."[22] The Commission should, therefore, adopt and release decisions on the Plan and the RTF recommendation simultaneously, in time for initial implementation to begin on July 1, 2001.[23]

II. THE PLAN'S OPTIONAL STRUCTURE AND DEFINITIONS OF PATH A AND PATH B BEST ADDRESS THE DIVERSITY OF NON-PRICE CAP LECs

The Commission should reject attempts of commenters to eliminate a basic element of the Plan: the two alternate regulatory paths -- "Path A" and "Path B" -- that would be available to non-price cap LECs.[24] The record demonstrates that these paths, designed to accommodate the great diversity of non-price cap LECs, are essential to a realistic plan for improved regulation of non-price cap LECs. As Innovative Telephone states, the Path A and Path B options in the Plan recognize that not all rate-of-return LECs can reasonably operate under an incentive-based

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21 *See, e.g.*, comments of CUSC at 17-18; Plains Rural Independent Companies at 14-16, TDS Telecom at 2-7.

22 *See* comments of TDS Telecom at 2.

23 In implementing the Plan, the Commission should follow the schedule proposed by the National Exchange Carrier Association ("NECA") in Attachment 1 to the comments of the Group.

24 *See, e.g.*, comments of AT&T at 13-14; CUSC at 10-11; Illinois Commerce Commission ("ICC") at 5-6.

regulation, even after access charges are reformed.[25] Some LECs serve areas, such as insular areas, with so many operational and investment challenges that incentive regulation would be too unpredictable to be workable.[26] ITG points out that many small LECs have lumpy investment patterns and significant year-to-year fluctuations in operating expenses that are not compatible with incentive mechanisms such as the Path A incentive mechanism, which is based on a stable Revenue Per Line ("RPL") standard.[27] To address these situations, traditional rate-of-return regulation should be available to non-price cap LECs in the form of Path B. The California PUC notes that the Plan's two-path structure apparently would have practical or administrative consequences that are no more complex than those posed by the CALLS proposal.[28] The record amply shows as well that retaining rate-of-return regulation in an optional Path B is necessary for sufficient long-term cost recovery and service quality for non-price cap LECs.[29]

The Commission should not adopt AT&T's suggestion that the Commission replace the Path A/Path B approach of the Plan with an alternative two-tier approach.[30] Under that approach, a draconian form of incentive regulation would be mandatory for the "largest" non-price cap LECs, with such regulation optional only for the "smaller" LECs. AT&T's approach would be a radical departure from the Commission's implementation of price cap regulation, under which that form of regulation was optional for small and mid-sized LECs.

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25 *See* comments of Innovative Telephone at 5-6.

26 *See id.* at 6.

27 *See* comments of ITG at 9.

28 *See* comments of California PUC at 11.

29 *See* comments of Plains Rural Independent Companies at 2-13.

30 *See* comments of AT&T at 13-14.

Not only is AT&T's incentive plan untenable on its own terms, but the mandatory nature of its proposal completely ignores the diversity among non-price cap LECs that the record establishes so clearly.[31] Nor is it realistic for the Commission to distinguish between the "largest" and the "smaller" non-price cap carriers in attempting to predict which should be subject to incentive regulation. AT&T fails to define its criteria for determining the "largest" non-price cap carriers. However, it is improbable that there is a logical link between the size of any non-price cap LEC and the need for mandatory incentive regulation. Similarly, CUSC's argument that all non-price cap LECs should be placed on incentive regulation[32] fails to recognize the diverse operating conditions and resources of non-price cap LECs.

CUSC attacks non-price cap LECs' discretion under the Plan to choose between Path A and Path B.[33] However, such discretion is completely consistent with the current ability of these LECs under the Commission's rules to choose between price cap and rate-of-return regulation. The election between Path A and Path B, like that between price cap and rate-of-return regulation, is one-way – that is, a carrier that elects Path A cannot decide to return to Path B. Similarly, once a Path A LEC decides to move a study area from rate-of-return regulation to incentive regulation during the five-year transition period, that study area cannot return to rate-of-return regulation. These one-way limitations on LECs' discretion under the Plan are effective controls on regulatory gaming and manipulation. As structured, the Path A and Path B options

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31 *See, e.g.*, comments of the Group at 4, *citing* RTF, *The Rural Difference*, White Paper 2 (Jan. 2000).

32 *See* comments of CUSC at 12.

33 *See id.* at 12-13.

presented in the Plan for all non-price cap LECs are the best means of determining the most suitable form of regulation for individual non-price cap LECs.

III. THE PLAN'S ACCESS RATE CHANGES STRIKE THE PROPER BALANCE IN REFORMING COST RECOVERY

Commenters from many telecommunications sectors support the Plan's proposal to increase SLCs to the levels of the caps established in the *CALLS Order*.[34] The Commission should adopt the Plan's proposals for the timing and magnitude of such SLC increases, which were designed to balance understandable customer concerns about rate shock with the need to improve recovery of common line costs. The Commission should reject suggestions to increase the multi-line business SLC from its current level of $6.00 per line to $9.20 per line immediately, rather than over two years as proposed in the Plan.[35] To flash-cut a SLC increase of over 50% would impose severe rate shock on the business customers of non-price cap LECs. WorldCom's claim that "[i]ncreasing the SLC cap to $9.20 in one step would have no impact on subscribership"[36] is both unsupported and completely ignores the interests of the business customers of non-price cap LECs.

Nor should the Commission change the Composite Access Rate ("CAR") from the Plan's approach of transitioning to a level of 1.6 cents per minute as of July 1, 2003. Although some

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34 *See supra* note 3.

35 *See* comments of AT&T at 5; Sprint at 6; WorldCom at 8-9 (advocating increase "in one step").

36 *See id.* at 8.

IXCs call for the CAR or some similar composite rate to be prescribed at .95 cents per minute,[37] there is no reasonable basis to do so. The basis for the IXCs' argument is that .95 cents per minute is the target rate adopted in the CALLS Order for primarily rural price cap LECs.[38] Yet that rate is a product of the CALLS negotiations. The price cap LECs subject to the .95 cents per minute target rate - those serving "primarily rural" areas - have vastly different resources and cost structures than the more than 1000 non-price cap LECs that will be subject to the Plan. Moreover, in contrast to the CAR, the .95 cents per minute rate in CALLS is a target. It is not prescribed as the CAR will be under the Plan.

Lower per minute access rates, which benefit the IXCs that purchase access, necessarily will place an additional burden on universal service funding, which is borne by all providers of telecommunications services and their customers. Rather than increase the tension inherent between universal service and access reform, the Commission should adopt the CAR proposed in the Plan, as well as the rest of the Plan in its entirety.

The CAR proposed in the Plan is much more reasonable for non-price cap LECs because at the 1.6 cents per minute level, the CAR reflects a percentage reduction in the per-minute switched access rates of non-price cap LECs comparable to that of the *CALLS Order*. Even so, as the Plains Rural Independent Companies observe, a CAR of 1.6 cents per minute is below the cost of providing access for many small LECs.[39] A reduction to .95 cents per minute would represent a percentage reduction much greater than what the *CALLS Order* required for the

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37 *See, e.g.*, comments of AT&T at 6-7 (proposing that all rate-of-return carriers reduce their average traffic sensitive rate to $.0095 on July 1, 2001); GCI at 3 (proposing that CAR be set at .95 cents per minute); Sprint at 5-6 (referring to rates of $.0065 and $.0095).

38 *See CALLS Order* paras. 142, 177.

39 *See* comments of Plains Rural Independent Companies at 11-12.

carriers subject to it. The absolute reduction from current per-minute rates represented by a CAR of 1.6 cents per minute is significantly greater than the reductions in the *CALLS Order*. Because NECA's ability to band rates is unchanged under the Plan, CAR rates lower than the 1.6 cents per minute level will be available for lower-cost Path A LECs.

The Commission should not prescribe the CAR at any particular level for Path B LECs.[40] Under the Plan, SLCs will increase for Path B LECs. Therefore, per-minute access rates will decrease compared to what they would have been if the SLC increases had not taken place.

The Commission should also reject attacks on a crucial aspect of the Plan: the requirements that enforce the geographic averaging requirement of section 254(g) of the Act.[41] With the more economically efficient access charges that will result from the Plan, IXCs will more readily be able to satisfy the section 254(g) requirement. Under the Plan, IXCs must pass through to long distance customers the savings that IXCs realize from lower access rates charged by the non-price cap LECs subject to the plan. If, as various IXCs claim, competition will force them to do so, they should have little difficulty complying with this portion of the Plan. The Commission's experiences with AT&T's proposed rate changes after release of the *CALLS Order* indicate that the IXCs' claims in this area should be viewed skeptically.[42]

The Plan requires IXCs to offer the same optional calling plans to rural and urban customers alike, and otherwise eliminates IXCs' minimum monthly charges for long distance

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[40] *See, e.g.*, comments of AT&T at 3 (advocating traffic-sensitive rate of $.0095 for all non-price cap carriers); ICC at 6-7.

[41] *See, e.g.*, comments of Regulatory Commission of Alaska ("RCA") at 6 (supporting intent of proposal).

[42] *See, e.g.*, Steven Labaton, *Yielding To Embarrassed F.C.C., AT&T Delays Its Rate Increase*, The New York Times (Late Edition Final, Jun. 8, 2000) at A1; *AT&T Promises Savings – Watch Your Wallet*, Communications Today (Jun. 12, 2000).

service customers in non-price cap LEC service areas.[43] Although IXCs predict dire results from the proposed rule, including the specter of their withdrawal from the service areas of non-price cap LECs altogether,[44] such prophecies are speculative at best. Basic equity demands that rural consumers have access to the same optional calling plans available elsewhere.[45] Sprint claims that in 1996, the Commission exempted optional calling plans from the geographic averaging requirements of section 254(g).[46] Sprint neglects to mention that in the very decision it cites, the Commission stated:

> Contrary to the claims of some IXCs, *we have not exempted from our geographic rate averaging policy entire groups of services, such as* contract tariffs, negotiated arrangements, or *optional calling plans*, where carriers offer discounted rates on a permanent or long-term basis.[47]

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43 Under the geographic comparability standards of section 254(g), if a minimum monthly charge for long-distance service were impermissible in the service areas of non-price cap LECs, it presumably would be impermissible in other areas as well.

44 *See* comments of Sprint at 11-12.

45 *See, e.g.,* AT&T Communications Tariff FCC No. 27, Optional Calling Plans and Discounts, §4.2.18.E, orig. page 4-61 (restricting availability of AT&T Green Sense Plan); I-Link Worldwide, LLC, Pricing and Services Guide, rev991202, at 1 (stating that V-Link Calling Flat Rate Service "[e]xcludes calls originating in NECA areas (specific remote areas served by small, independent carriers.)").

46 *See id.* at 11, *citing Policy and Rules Concerning the Interstate, Interexchange Marketplace: Implementation of Section 254(g) of the Communications Act of 1934, as amended*, 11 FCC Rcd 9564, 9577 (1996).

47 *Id.*, 11 FCC Rcd at 9577 para. 28 (emphasis added).

The Commission made clear that:

> As with current policy, we will require carriers to offer the same basic service package to all customers in their service areas, and permit carriers to offer contract tariffs, Tariff 12 offerings, and optional calling plans provided they are available to all similarly situated customers, regardless of their geographic location.[48]

The Plan's proposed rule regarding optional calling plans puts teeth into this policy, and benefits consumers by ending any uncertainty about the Commission's intentions with respect to such plans. As noted in the initial comments, the Commission has full authority to enforce this rule under section 254(g) as well as its prior practice.[49] Indeed, present section 64.1900 of the Rules assists enforcement of the proposed rule by requiring nondominant IXCs to file annual certifications that they satisfy the geographic rate averaging and rate integration obligations of section 254(g) of the Act. The current deadline for the first of those certifications is August 1, 2001.[50]

IV. THE PLAN'S UNIVERSAL SERVICE SUPPORT SYSTEM SATISFIES THE GOALS OF THE ACT

The Commission should adopt the many reforms of the universal service system proposed in the Plan. As the Wisconsin PSC states, the Commission should immediately remove

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48 *Id.* para. 27.

49 *See* comments of the Group at 30-31; Wisconsin PSC at 7-8.

50 *See Common Carrier Bureau Extends Deadline For First Annual Certification Of Compliance With Geographic Deaveraging And Rate Integration Requirements To August 1, 2001*, CC Docket No. 96-61, Public Notice, DA 01-473 (rel. Feb. 21, 2001).

the "interim" cap on high cost loop support.[51] The Commission should also remove the corporate operations expense limitation.[52] While arbitrarily limiting the universal service support available to all carriers, the caps restrict support for the neediest areas.[53] As the Wisconsin PSC notes, caps, including the mechanism proposed by the RTF, effectively shift some of the federal universal service burden to the states.[54] They introduce unpredictability for incumbent LECs and CLECs, because increased support for any carrier decreases the support available for other carriers. Eliminating these caps will provide LECs with greater incentives to provide improved basic services while making investments that will accommodate the delivery of advanced services in high cost areas.[55]

To control universal service funding, when a pooling Path A LEC becomes subject to incentive regulation in a study area, the Plan freezes per-line universal service support flows at the level that the LEC is receiving immediately before the effective date of incentive regulation, subject to annual adjustments for inflation.[56] This targeted, per-line approach to controlling

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51 See comments of Wisconsin PSC at 6-7. The Plan proposes removal of the cap on high cost loop support and the corporate operations expense limitation. The Wisconsin PSC supports the Plan's proposal to remove all caps, *id.* at 7, but focuses on the cap on high cost loop support.

52 *See, e.g.*, comments of Alaska Telephone Association at 3 (stating that caps are unjust restrictions on rural carriers and unfair impediments to service comparable to urban markets).

53 *See* comments of JSI at 8.

54 *See* comments of Wisconsin PSC at 6.

55 *See* comments of JSI at 6-7.

56 Per-line support is also subject to adjustment if the definition of supported services changes, and for the costs of complying with other government regulation for which direct cost recovery has not been provided.

universal service support is far preferable to the present broad, unfocused caps on such support.[57] The Plan's approach produces the predictability needed for incumbent LECs to invest and CLECs to evaluate the economics of entry.

The Commission should not alter Rate Averaging Support (the "RAS"), the explicit and portable universal service support mechanism defined in the Plan.[58] While supporting the Plan's efforts to make universal service support more explicit, commenters propose a variety of changes to the RAS that harm the Plan's ability to address policy issues involving access, universal service, competition, and incentive regulation in an integrated way that reflects the diversity of non-price cap LECs.

The RAS should not be available to all non-price cap LECs.[59] In universal service reform, the Commission has broad discretion to balance the goals of providing explicit and sufficient universal service support and promoting local competition.[60] Implementation of the RAS as described in the Plan is a sound exercise of this discretion. The immediate availability of the RAS in Path A should motivate non-price cap LECs to move to Path A and incentive regulation.[61] Path A incentive regulation in turn will send the proper economic signals to

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57 *See* comments of TCA at 6 (stating that the Plan's limits on high cost loop support are superior to those proposed by the RTF).

58 Contrary to some misperceptions in the record, *see, e.g.*, comments of California PUC at 9 and CGI at 6, the Plan does not require competitive ETCs to join the NECA pooling system to receive portable universal service support.

59 *See, e.g.*, comments of CUSC at 10-11; AT&T at 9-10.

60 *See CALLS Order* para. 192.

61 Indeed, comments of some consulting organizations and the small non-price cap LECs support the availability to Path B LECs of the RAS as it is otherwise defined in the Plan. *See, e.g.*, comments of the ICORE Companies at 17-18. Such comments provide indirect evidence

promote efficient investment and efficient competitive entry. The Plan's one-way optionality will encourage the shift to Path A and promote competition among a greater number of carriers.

The Commission has strong policy reasons and ample legal discretion to associate the RAS with Path A rather than Path B. For Path B LECs, the existing universal service support structure will be permissible under the Act, as it is now.[62] Although CUSC argues that Path B without the RAS undermines competitive neutrality because Path B LECs will receive implicit support through access charges, the reality is far less dramatic. Because SLCs will increase for Path B LECs under the Plan, per-minute access rates will decrease for Path B compared to what they would have been without SLC increases, and implicit subsidies will decrease. Existing portable forms of universal service support will continue to be available in Path B as well.

As a residual mechanism for supporting access charge reductions, the RAS should not be subject to caps or fixed at a specific size, as some parties argue.[63] Although the RAS is a residual mechanism, it does not serve to "guarantee" particular revenue levels or rates of return for Path A LECs.[64] Because the RAS is portable, if a competitor wins a line from a Path A LEC, the competitor wins the associated RAS support as well. Path A LECs eligible to receive the RAS are not guaranteed the authorized rate of return under present forms of interstate regulation,

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that the presence of the RAS in Path A may provide a powerful incentive for non-price cap LECs to elect Path A.

62 Path B LECs will be situated differently from Path A LECs. Among other things, the Plan does not prescribe per-minute access rates for Path B LECs as it prescribes the CAR for Path A LECs.

63 *See, e.g.*, comments of California PUC at 17-18; CUSC at 9-10; Sprint at 9; WorldCom at 13-15.

64 *See* comments of CUSC at 8-9; Public Service Commission of Missouri at 3.

and Path A incentive regulation makes no such guarantee. To the contrary, Path A regulation freezes revenues per line in real terms.

As the Group demonstrated in its initial comments, a capped RAS would not assure that funding would be sufficient pursuant to section 254 of the Act. Unlike the "interstate access support" mechanism of the *CALLS Order*, which is capped at $650 million per year, the RAS must meet the universal service needs of the diverse non-price cap LECs that would be subject to the Plan, which have widely varying universal service needs. As the Group explained in its initial comments, for the first years of the Plan the RAS is estimated to be smaller than the "interstate access support" mechanism of the *CALLS Order*, depending on assumptions about participation in both Path A and the pool.

Although commenters oppose use of part of the RAS to support special access services,[65] this portion of the RAS is essential to prevent potential rate shock. This portion of the RAS will also ensure investment in and deployment of the modern technology needed for efficient delivery to rural areas of services supported under the universal service program. Such investment will also help support advanced services, such as the different varieties of DSL, that function best using modern technologies. Because such services are often highly competitive outside the service areas of non-price cap LECs, this use of the RAS will ensure that competition is not stifled by the inability of all carriers to compete in high-cost areas. The special access portion of the RAS will also help keep switched transport rates in these areas reasonably comparable to those in more urban areas, since the transport rates for switched services are largely based on special access rates. This portion of the RAS will be portable to competing ETCs as well.

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[65] *See, e.g.*, comments of California PUC at 17-18; Sprint at 8; AT&T at 11.

While some commenters oppose the Plan's provisions for disaggregation of universal service support,[66] the need for such disaggregation is well established. Under Path A and Path B, LECs will have the ability to disaggregate universal support per line into no more than three zones per study area. LECs must file these zones and the corresponding per-line support amounts with the Commission, the Universal Service Administrative Company ("USAC") and relevant state regulators. Such zoned support will help non-price cap LECs, as carriers of last resort, determine reasonably cost-based levels of portable support for regions within their service areas with different cost characteristics.

Although some commenters appear to be concerned that disaggregation will result in anti-competitive gaming, such concerns are groundless. Non-price cap LECs have every incentive to ensure that support is directed to the most costly of their service areas.[67] The zones and per-line support amounts will be publicly available information, and regulatory authorities will have authority to ensure that such disaggregation is competitively neutral. The zones and per-line support amounts must remain in effect for at least four years, a requirement that limits the possibility of gaming.

Some commenters express concern about the overall size of universal service funding,[68] noting that IXCs and LECs already contribute about 6.7% of their interstate and international end user revenues, which in turn is recovered from their customers. The Group submits that the rural areas served by non-price cap LECs continue to be the focus of universal service policies in the

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66 *See, e.g.,* comments of Ad Hoc Telecommunications Users Committee ("AHTUC") at 22-23; RCA at 7-8; Association of Communications Enterprises ("ASCENT") at 6.

67 *See* comments of Plains Rural Independent Companies at 14.

68 *See, e.g.,* comments of Qwest at 5-6; Sprint at 8-9.

United States, and that whatever competing uses exist for universal service funding, these areas and the LECs that serve them should receive sufficient support under the Act. Sprint expresses concern that additional universal service-related charges associated with the Plan will drive IXC end users to alternative providers, such as Internet providers.[69] Universal service support should not be held hostage to Sprint's competitive concerns. A flexible residual mechanism such as the RAS is best able to meet the statutory goals of being explicit and sufficient to achieve the purposes of section 254 of the Act.[70]

V. PATH A OF THE PLAN PROVIDES STRONG INCENTIVES FOR EFFICIENT INVESTMENT AND OPERATIONS

The Commission should adopt Path A and its form of incentive regulation as presented in the Plan. Path A provides the correct signals and incentives for efficient investment and operations by non-price cap LECs operating in a pooling environment. Although some commenters complain that aspects of Path A are "too generous" or otherwise do not present proper incentives to non-price cap LECs, these criticisms are overstated. In many cases, they depend on incorrect analogies between price cap regulation of the largest LECs and the RPL regulation proposed for Path A, which is appropriate for the smallest LECs, most of which operate in the NECA pooling environment.[71]

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69 *See id.*

70 *See* 47 U.S.C. §254(e).

71 Some commenters, such as the ICC, assume incorrectly that Path A incentive regulation is a price cap plan. *See* comments of ICC at 4, 7, 10. Because Path A incentive regulation freezes RPL in real terms, rather than capping prices, the Commission should reject as unnecessary the ICC's call for NECA to provide various cost studies to the Commission and state regulators. *See* comments of ICC at 10-11. Path A incentive regulation does not require

Path A's transition mechanism for moving from existing forms of rate-of-return regulation to RPL incentive regulation should be adopted. Although, as noted above, some parties express concern that Path A LECs will "gold plate" their networks prior to conversion to incentive regulation, such concerns are ill founded. They ignore that non-price cap LECs will be subject to state and federal regulation prior to converting to incentive regulation, and that a significant portion of any investment must be recovered from the intrastate jurisdiction. They also fail to acknowledge the reality that the investment cycles of small LECs are both "lumpy" and relatively lengthy because of their small size, limited investment resources, and the effects of state regulation.[72] The length of the proposed transition period accommodates such investment patterns while ensuring timely implementation of incentive regulation.

The Commission should permit non-price cap LECs to convert to Path A incentive regulation during the transition period on a per-study area basis. Concerns about improper cost shifting among study areas are entirely speculative. Current accounting safeguards and reporting requirements are more than adequate to prevent such cost shifting. As competition grows in the service areas of rate-of-return LECs, competitive pressures on rates will reduce any incentives to shift costs.

The Commission should reject calls to add a "productivity factor" or similar X-factor onto Path A incentive regulation.[73] Although the Group discussed this issue thoroughly in its

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the Commission "to specify appropriate initial rate levels," *see id.* at 10, because it is not price cap regulation. Thus, the basis for the ICC's request is incorrect.

[72] *See* comments of ICORE companies at 12-14 (supporting a five-year transition period); *cf.*, comments of ITG at 12-14 (advocating a seven-year transition period).

[73] *See, e.g.*, comments of AHTUC at 16-17; Global Crossing at 7-8; ASCENT at 3; WorldCom at 4-5; NASUCA at 19; ICC at 7-9; AT&T at 15-17. AT&T even calls for

initial comments,[74] some additional points are important. As some small LECs and their representatives note, rural LECs do not have the size or operating scale to make the adjustments necessary to accommodate an annual productivity offset.[75] Moreover, as ITG explains, the Commission did not impose mandatory price cap regulation on small and mid-sized LECs because it was unreasonable to subject them to a form of incentive regulation based on the historical performance of the largest LECs, including the productivity estimates that comprise the price cap X-factor.[76] The Group agrees that there is no need for imposition of an X-factor in Path A incentive regulation.

In this regard, AT&T presents an analysis in its comments that purports to show that Path A incentive regulation should include a productivity factor to reflect LEC productivity gains in switching and transport. However, the time period chosen by AT&T for its analysis, 1995-1999, was one of very strong economic growth. Based on data from the Bureau of Economic Analysis, U.S. Commerce Department, growth in real domestic product averaged 2.21% per year during the 1990-1994 time span. Over the next five-year period, 1995-1999, selected by AT&T, the average jumped to 3.85% per year. During such a time, capital-intensive industries, such as the wireline telecommunications industry, benefit from increases in demand because industry

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imposition of a so-called "consumer productivity dividend," ***see id.*** at 16-17, although the D.C. Circuit has expressed skepticism about the calculation of such a dividend in the price cap context. *See United States Telephone Association v. FCC*, 188 F.3d 521, 527 (D.C. Cir. 1999).

[74] *See* comments of the Group at 24-25.

[75] *See* comments of the Western Alliance at 12-13.

[76] *See* comments of ITG at 15-16. Indeed, non-price cap LECs serve many areas of the country where economic growth is low, in contrast to the high growth areas served by the largest, price cap LECs.

costs do not increase as quickly as demand. During that time period, there also was significant growth in the use of second lines for Internet connections and facsimile machines.

At present, however, wireline telecommunications providers are entering a period of slower economic growth and much fiercer competition with the cable and wireless industries.[77] Second line growth is slowing, and is likely to slow further when users convert to DSL and cable modems. Productivity is likely to decline substantially as demand is lost to competitors, and LECs invest in an effort to keep their customers. In this regard, NECA recently concluded that more than $10.9 billion is needed to upgrade telephone lines served by rural telephone companies to broadband capability.[78] In addition, if and when non-price cap LECs lose lines to competition, the costs associated with the lost lines will largely continue. As carriers of last resort under intrastate tariffs, many non-price cap LECs are required to maintain all of their facilities and stand ready to serve if a competitor exits their service area or customers switch back.

AT&T's analysis includes several assumptions that cast doubt on the validity of its productivity estimate. These assumptions highlight the difficulty of deriving a reliable productivity estimate. Such estimates are very sensitive to small adjustments in the data on which they are based. For example, AT&T's analysis assumes an 0.85% annualized growth in traffic sensitive ("TS") revenue requirement. This assumption contrasts with NECA's filed data, which shows that the average annual cost company revenue requirement growth rate for the 1995

[77] *See, e.g.*, Judy Sarles, *Wireless Users Hanging Up on Landline Phones*, Nashville Business Journal (Feb. 2, 2001).

[78] *See* Letter from NECA to Magalie Roman Salas, Secretary, FCC (June 21, 2000), transmitting Summary of Results of Broadband Study; *Telephony*, Communications Daily (June 22, 2000) at 2.

to 1999 period was 5.3% for TS Switched and 25.7% for TS special access.[79] AT&T also uses a minutes-based revenue share to inflate TS pool revenue to the entire rate-of-return group. This per-minute factor is used to inflate both TS switched services and TS special access services.

Use of such a factor is problematic because special access services are not based on per minute rates. Indeed, AT&T limits its analysis to the 1995-1999 period because it recognizes the inaccuracies of its estimates for the 1990-94 period. Although AT&T claims that many LECs exited the pool during the 1990-1994 period, LECs were also entering and exiting the pool during the 1995-1999 period. Pooling LECs also acquired lines from price cap LECs during this period, often at prices lower that those of lines acquired from rate-of-return LECs, which could skew the overall cost per line. Such use of inconsistent data calls into question the utility of a minutes-based inflation factor for the 1995-99 period.

In contrast to AT&T's backward-looking analysis, the Group estimates that during Path A's initial five-year transition period, the Plan is revenue-neutral for non-price cap LECs.[80] Because revenues do not increase during that period under the Plan compared to the present

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79 *See* NECA, Annual Tariff Filing, Vol. 2, Ex. 5 (Jun. 2000). These historical growth amounts are for consistent tariff participation (*i.e.*, they do not include any study areas that entered or exited the pool) and reflect adjustments to exclude the impacts of acquisitions, conversions and new study areas.

80 *See* comments of the Group at 9, *citing* Letter to Magalie Roman Salas, Secretary, FCC, from William F. Maher, Jr., Counsel for the Group (Dec. 8, 2000) ("December 8 Filing"). Under the Plan, interstate access revenues, plus the new explicit universal service support mechanism known as RAS, are estimated to be about the same as access revenues are projected to be for non-price cap LECs throughout the Plan's proposed five year transition period. This estimate assumes that the current regulatory structure, authorized rate of return, and access charge levels are maintained during the Plan's five-year transition period which begins on July 1, 2001. The December 8 Filing contains numerous assumptions and qualifications regarding its estimates that are incorporated herein by reference.

regulatory system, there is no need for imposition of an X-factor to attempt to account for productivity or to restrain revenue growth.

The differences between price cap regulation and Path A incentive regulation, which freezes RPL in real terms, are also important when considering the X-factor issue. Under price cap regulation, a firm's prices are capped but its revenues are not capped. For price cap LECs, revenues from services based on per minute rates can increase as minutes of use increase, *e.g.*, through demand stimulation. Price cap LECs benefit from such increased usage. An X-factor functions to share the benefits of such usage with customers, primarily the IXCs. In addition, a price cap LEC's revenues on a per line basis can increase as the number of lines grows.

In contrast, Path A incentive regulation freezes a Path A LEC's RPL in real terms. Such regulation, without any X-factor applied to RPL, limits the LEC's real revenue growth to line growth. For services priced on a per minute basis, Path A incentive regulation bars a Path A LEC's revenues from increasing as minutes of use increase, even if minutes were to increase dramatically. The beneficiaries of such increased minutes will be all contributors to universal service, not only IXCs, because in the Plan's pooling environment, increased minutes of use would yield pool revenues that help satisfy the pool's revenue requirement, limiting the size of the RAS. This in turn limits contributions to the RAS from all universal service contributors, not only IXCs, without imposition of an X-factor.

Nor should the Commission alter the low end adjustment proposed in the Plan. Although some parties claim that the proposed adjustment dilutes LECs' incentives to act efficiently,[81] a low end adjustment mechanism has been a longstanding component of price cap regulation, and

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[81] *See, e.g.*, comments of GCI at 6; CUSC at 16.

continues as such under the *CALLS Order*.[82] It is a valuable means of ensuring that Path A LECs make investments in new telecommunications services and technologies in their high-cost service areas. Of course, the Plan's low end adjustment does not guarantee the authorized rate of return to Path A LECs, since the adjustment is to specified levels below that figure, depending on the number of study areas that a LEC serves.

The low end adjustment will become increasingly important as competitive entry grows in the service areas of Path A LECs. Competition will focus on the low-cost, high-volume business customers in Path A LECs' service areas. However, these LECs will continue to have carrier-of-last-resort obligations for high-cost residential customers. The low end adjustment will be an important backstop to ensure that returns will be adequate for Path A LECs to continue to invest in and improve their networks. As the Western Alliance notes, rural LECs do not have the size, scale, or financial resources of larger LECs, and thus cannot smooth their investment patterns while surviving unforeseen expense increases due to storms or customer relocations. The low end adjustment will help small LECs to remain financially and operationally stable in the face of such fluctuations.[83]

The low end adjustment proposed for LECs with five or fewer study areas is reasonable. As proposed in the Plan, such LECs that realize study area returns more than 50 basis points less than 11.25% would be entitled to a one-time earnings adjustment to bring their study area return

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82 The low end adjustment proposed in the Plan would be significantly more limited than that available to price cap LECs, since any given adjustment would be in effect for one year only.

83 *See* comments of the Western Alliance at 14. Innovative Telephone expresses concern that the mechanism proposed in the Plan is inadequate for carriers located in high-risk regions, such as islands that are subject to catastrophic hurricanes and other weather-related damage. *See* comments of Innovative Telephone at 10-11.

for the relevant year to 10.75%. Many LECs with so few study areas are located in a relatively small geographic locale, *e.g.*, in a single contiguous service area, or in neighboring study areas in adjacent states. The Plan recognizes that such localized LECs may be subject to greater risks, including natural disasters and adverse economic conditions, than those with more dispersed study areas.

Some commenters criticize the Plan's continued reliance on NECA's centralized tariff and pooling system.[84] However, the record shows that pooling is compatible both with incentive regulation and with implementation of the Plan as a whole.[85] The Plan makes use of the NECA pooling process to provide substantial administrative savings for LECs, IXCs, the Commission and ratepayers. Implementing the Plan in the context of NECA's centralized tariffing function will avoid the need for hundreds of individual tariff filings by non-price cap LECs, all of which would need to be developed, reviewed and maintained on an ongoing basis.

Moreover, AT&T is incorrect that pooling is not compatible with incentive regulation. NECA has considered carefully the mechanics of incentive-based settlement mechanisms within the pooling environment.[86] Since the inception of the NECA pooling process, about half of the

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84 *See* comments of California PUC at 9-10 (claiming that the NECA pools are an implicit form of universal service funded solely by LECs); AT&T at 15 (stating that pooling by companies subject to incentive regulation should not be permitted).

85 *See, e.g.*, Attachment 1 to comments of the Group (stating NECA's conclusions regarding the administrative feasibility and implementation schedule of the Plan).

86 In fact, NECA proposed a form of optional pool incentive regulation as long ago as 1993. *See The National Exchange Carrier Association, Inc. Proposed Revision of Part 69 of the Commission's Rules to Allow for Incentive Settlement Options for NECA Pool Companies*, RM 8389, Petition for Rulemaking (filed Nov. 5, 1993). That petition was filed in response to a suggestion by the Commission encouraging NECA "to continue to work on reforms to introduce optional incentive plans into the pooling process. . . ." *See Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation*, 8 FCC Rcd 4545, 4562 (1993).

participating exchange carriers have received settlements on the basis of the average schedules, which is a form of incentive regulation that operates successfully within the NECA pool environment.[87] Path A incentive regulation is designed to operate in the pooling environment. The incentives that it presents to customers will be especially effective as NECA continues to update pooling mechanisms to align rates more closely with costs through the use of tools such as rate banding.[88]

VI. THE PLAN PROMOTES EFFICIENT DEPLOYMENT OF ADVANCED SERVICES

The Plan charts a careful course in promoting the deployment of advanced services. The Plan avoids any required use of universal service funding to support advanced services. As a policy matter, the Plan is not designed to change the definition of services eligible for universal service funding to include advanced services, although it is able to accommodate such changes. The Plan provides strong incentives for non-price cap LECs to invest in new infrastructure through the move to Path A incentive regulation, the removal of the current cap on high cost loop support, and the creation of a more stable environment for telecommunications investment by the non-price cap LECs. The resulting infrastructure investments will likely be capable of supporting advanced services as well as services currently supported through the universal service program.

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87 *See Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, 6820 (1990) (stating that "[t]he settlements that an average schedule company receives depend upon the demand for the services that it provides rather than upon its costs of providing those services. *As a consequence, average schedule companies are already subject to a form of streamlined regulation that creates economic incentives similar to those we seek to foster by adopting price caps for other exchange carriers.*" (emphasis added)).

88 The NECA tariff specifies discrete ranges or "bands" for rates that apply to an exchange carrier based on its costs. The Plan explicitly allows for continuation of rate banding.

Although some commenters criticize the Plan for not containing specific commitments to build out advanced services,[89] the Group believes that such commitments would be ill advised. There is a very real danger that the commitments could be inefficient or impractical manifestations of governmental "industrial policy" regarding advanced services. As competition grows in the service areas of non-price cap LECs, commitments by non-price cap LECs to upgrade facilities or services that are based only on a regulatory *quid pro quo* could place them at a competitive disadvantage. Moreover, it is impractical for the Group to even purport to commit such a large and diverse group of predominantly small businesses as the non-price cap LECs to a particular investment program for advanced infrastructure or services. Instead, the Plan's reliance on investment incentives and its promotion of regulatory certainty are far superior means of ensuring efficient deployment of advanced infrastructure and services.

VII. THE PLAN REFORMS THE COMMISSION'S RULES REGARDING MERGERS AND ACQUISITIONS INVOLVING NON-PRICE CAP LECs

The Commission should not hesitate to repeal several of its rules that discourage non-price cap LECs from acquiring and upgrading the exchanges and facilities of other LECs. The record clearly demonstrates that, in contrast to the hypothetical concerns raised by some parties, these rules impose few benefits and many burdens on non-price cap LECs. As the Wisconsin PSC shows, the Commission should repeal section 54.305 of the Rules, which artificially limits universal service support in exchange acquisitions.[90]

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[89] *See, e.g.*, comments of the Public Utility Commission of Texas at 3 (stating that most incentive regulation plans require the carrier to "*do something*" in return for added flexibility (emphasis in original)).

[90] *See* comments of Wisconsin PSC at 4-5.

The Commission should eliminate the "all-or-nothing" rule under which a LEC choosing price cap regulation is required to shift all of its affiliates to price cap regulation as well. As the Group's comments show, the rule is no longer needed, if it ever was, because of the growth of competition and the availability of other safeguards.

The Commission also should repeal the freeze on study area boundaries for non-price cap carriers. Its policy goals can be met as well, and much less intrusively, by the Plan's proposed prior notification requirement for mergers with or acquisitions of other LEC exchanges or operations.

VIII. CONCLUSION

The Group urges the Commission to adopt the Plan as filed, as expeditiously as possible in coordination with its action on the RTF recommendation.

Respectfully submitted,

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